



April 21, 2006

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

RE: Comment on Part 715 ANPR, Supervisory Committee Audits

Dear Ms. Rupp:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions (FCUs), I am responding to the National Credit Union Administration Board's (Board) advance notice of proposed rule (ANPR) making and request for comments regarding whether and how modifications should be made to its Supervisory Committee audit rules.

The Board has requested comments specifically on whether and how to require credit unions to obtain an "attestation on internal controls" in connection with their annual audits; to identify and impose assessment and attestation standards for such engagements; to impose minimum qualifications for Supervisory Committee members; and to identify and impose a standard for the independence required of State-licensed, compensated auditors. NAFCU appreciates this opportunity to comment on the issue of additional requirements for Supervisory Committee and believes that any proposed regulations increasing the compliance burden on credit unions must be carefully evaluated.

Oversight of public companies, including for profit financial institutions, has been a hotly debated issue by industry experts, regulators and the regulated. The primary focus of this debate often has been the enormous cost associated with the required internal controls imposed by Section 404 of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), controls similar to those contemplated by the Board's ANPR.

Of particular relevance to credit unions and this debate, is a study conducted by the Independent Community Bankers of America (ICBA) in late 2004 and early 2005. ICBA's survey showed that the average total cost for a community bank to comply with Section 404 of Sarbanes-Oxley is \$202,142.¹ The average asset size of the community banks in the survey was \$482 million, with a range of between \$21 million and \$6 billion. Based upon the survey and the heavy regulatory burden, ICBA requested that community banks with assets of less than \$1 billion be exempted from Section 404 requirements. In its comments to the Securities and Exchange Commission regarding the implementation of the internal control provision of Section 404 of the Sarbanes-Oxley, ICBA stated that the requirements were "impairing their profitability" and "weakening their capital" among other detriments.² NAFCU believes that credit unions would be similarly affected, if not more so, because they are not for profit and have a restrictive capital structure, leaving less capital to absorb the heavy and burdensome implementation costs.

After careful consideration, NAFCU is unconvinced that the benefits to be gained from an attestation on internal controls requirement would surpass the demonstrated efficacy of existing requirements in part 715 or would outweigh the potentially debilitating implementation and maintenance costs.

To measure the extent to which such reports are necessary, the Board has asked a series of specific questions. In response to those questions, NAFCU submits the following comments.

Requirement for Attestation of Internal Controls

The Board has sought comment on whether to require credit unions to obtain an "attestation on internal controls" in connection with their annual audits and has posed several specific questions about such a requirement. The attestation would require management to report its assessment of the effectiveness of the internal control structure and procedures established and maintained by the credit union. It also would require an external auditor to examine, attest to and report separately on management's written assertions on the effectiveness of the internal control structure and procedures.

1. *Should part 715 require, in addition to a financial statement audit, an "attestation on internal controls" over financial reporting above a certain minimum asset size threshold?*

NAFCU understands that the current interest in requiring credit unions to obtain an attestation audit is based in part upon the General Accounting Office's, now General Accountability Office (GAO), recent reports which contained the

¹ Independent Community Bankers of America, *Survey on the Costs of Complying with Section 404 of the Sarbanes-Oxley Act*, March 4, 2005, available at <http://www.sec.gov/news/press/4-497/ccole033105.pdf>.

² Letter from Christopher Cole, Regulatory Counsel, ICBA, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (March 31, 2005)(available at <http://www.sec.gov/news/press/4-497/ccole033105.pdf>).

suggestion that NCUA could “gain an evaluation of an institution’s internal controls, comparable to other depository institution regulators, if credit unions were required, like banks and thrifts, to provide management evaluations of internal controls and their auditor’s assessments of such evaluations.” GAO, *Credit Unions: Financial Condition Has Improved, But Opportunities Exist to Enhance Oversight and Share Insurance Management (GAO-04-91) (GAO Report) at 81*. The GAO made this point again in 2005. GAO, *Issues Regarding the Tax-Exempt Status of Credit Unions (GAO-06-220T)* at 4.

While understanding the GAO’s position and NCUA’s request for comments on the issue, NAFCU believes that an attestation on internal controls requirement is unnecessary and inappropriate for credit unions for two major reasons.

First, the current requirements in part 715 provide adequate assurances on the accuracy and transparency of credit union financial statement reporting as appropriate for credit unions of all asset sizes. Evidence of the efficacy of part 715 can be found in the past and present financial strength and stability of the credit union industry and the fiscal soundness of the National Credit Union Share Insurance Fund. Working together, NCUA, credit union management and credit union Supervisory Committees have established an outstanding track record of strong financial reporting and safety and soundness.

Furthermore, where large asset size may represent increased risk, NCUA guidance strongly encourages credit unions to voluntarily provide an attestation report. NAFCU also understands that most large credit unions employ internal auditors who regularly review and test controls over financial reporting, further reducing risk.

Second, NAFCU believes that there would be a high and negative financial impact on credit unions required to obtain an attestation on internal controls audit. Our members’ research and that of their auditors indicates that the implementation costs could perhaps double current expenditures for an audit, but would depend on the individual credit union; however estimates range from an additional \$50,000 to \$1.5 million. These costs would have a direct impact on member services, perhaps even requiring in some instances that they be curtailed in order to meet the new audit requirements.

While NAFCU does not support a requirement for credit unions of a particular asset size to obtain an attestation audit, NAFCU supports NCUA’s strong encouragement of certain credit unions with significant risk to obtain such an audit.

2. *What minimum asset size threshold would be appropriate for requiring, in addition to a financial statement audit, an “attestation on internal controls” over*

financial reporting, given the additional burden on management and its external auditor?

If the Board should impose an attestation requirement, NAFCU believes that the minimum threshold should be set at one billion dollars, equal to the threshold set for banks and thrifts under the Federal Deposit Insurance Corporation Improvement Act (FDICIA). Smaller credit unions would find it difficult, if not impossible, to absorb the costs described above or would have to sacrifice member services to meet the requirement.

3. *Should the minimum asset size threshold for requiring an “attestation on internal controls” over financial reporting be the same for natural person credit unions and corporate credit unions?*

If the Board should impose an attestation requirement, NAFCU is unaware of any reason to treat natural person credit unions differently from corporates with regard to attestation. Therefore, the minimum asset size threshold should be the same.

4. *Should management’s assessments of the effectiveness of internal controls and the attestation by its external auditor cover all financial reporting (i.e., financial statements prepared in accordance with GAAP and those prepared for regulatory purposes), or should it be more narrowly framed to cover only certain types of financial reporting?*

If the Board should impose an attestation requirement, NAFCU believes the requirement should cover all financial reporting to include financial statements prepared in accordance with GAAP and those prepared for regulatory purposes. It is NAFCU’s understanding that the preparations under the two types is similar and that little would be gained from applying the requirement to just GAAP statements or those prepared for regulatory purposes.

5. *Should the same auditor be permitted to perform both the financial statement audit and the “attestation on internal controls” over financial reporting, or should a credit union be allowed to engage one auditor to perform the financial statement audit and another to perform the “attestation on internal controls?”*

If the Board should impose an attestation requirement, NAFCU believes that credit unions should be allowed to engage the same auditor to perform the financial statement audit and the attestation on internal controls. As both audit processes would be governed by GAAP, with its internal requirements for independence and prohibitions against conflicts of interest, there should be no reason to prohibit the practice.

Permitting the use of the same auditor might also serve to limit costs as the services of two different auditors would undoubtedly increase costs due to the

additional number of professional hours expended and the profit sought by both auditors. It is also likely that requiring a second firm to perform the attestation would increase costs to the credit union as it would need to bring the second firm “up to speed” so that it would have adequate knowledge to evaluate the work of the first auditor. Further, it might also be difficult for credit unions to engage an auditor willing to rely on the work done by another auditor.

Credit unions, however, should be permitted to engage two different auditors, if this arrangement would be in the best interest of the credit union.

6. *If an “attestation on internal controls” were required of credit unions, should it be required annually, or less frequently?*

If the Board should impose an attestation requirement, NAFCU believes that it should not require an attestation more frequently than once every three years.

7. *If an “attestation on internal controls” were required of credit unions, when should the requirement become effective (i.e., in the fiscal period beginning after December 15 of what year)?*

If the Board should impose an attestation requirement, NAFCU believes that it should provide adequate time for credit unions to plan, make capital allocations, hire staff (if applicable) and provide training, to establish programs and processes to accommodate the requirement and to engage an auditor. Therefore, NAFCU supports an effective date no earlier than 24 months after the regulation is made final. This effective date would be, we believe, consistent with the period afforded to public companies when first required to comply with the requirement by the Sarbanes-Oxley Act.

Standards Governing Internal Control Assessments and Attestations

8. *If credit unions were required to obtain an “attestation on internal controls,” should part 715 require that those attestations, whether for a natural person or corporate credit union, adhere to the PCAOB’s AS 2 standard that applies to public companies, or to the AICPA’s revised AT 501 standard that applies to non-public company?*

If the Board should impose an attestation requirement, NAFCU believes that the AICPA’s revised AT 501 standard would be the appropriate auditing standard for credit unions. This standard is more appropriate for credit unions because it is used to evaluate the financial statements of non-public companies such as credit unions. Credit unions are regulated by the NCUA, not the Securities and Exchange Commission, do not issue stock and do not have access to capital markets. Furthermore, in large part, the PCAOB standards were promulgated in response to gross malfeasance by certain public companies. The track record for

credit unions indicates that this type of malfeasance has not occurred in credit unions.

9. *Should NCUA mandate COSO's Internal Control—Integrated Framework as the standard all credit union management must follow when establishing, maintaining and assessing the effectiveness of the internal control structure and procedures, or should each credit union have the option to choose its own standard?*

Should the Board mandate a standard for establishing, maintaining and assessing the effectiveness of the internal control structure and procedures, NAFCU would support the use of the COSO standard. It is a widely accepted standard and an extensive amount of guidance is available to assist credit unions in its implementation. As a model, the standard could be adapted by credit unions to fit their individual needs (scale and complexity), thus avoiding a one-size-fits-all approach to the adoption of an internal control program. Furthermore, one required standard would help to ensure internal consistency and uniformity among credit unions.

Qualifications of Supervisory Committee Members

10. *Should Supervisory Committee member of credit unions above a certain minimum asset size threshold be required to have a minimum level of experience or expertise in credit union, banking or other financial matters? If so, what criteria should they be required to meet and what should the minimum asset size threshold be?*

NAFCU believes that Supervisory Committee members shoulder a great responsibility for the safety and soundness of their credit unions. This responsibility entails a commitment to understanding their role and the nature of the Supervisory Committee's work, which requires an engagement with the financial methods, practices and processes of credit unions. Yet, not all credit unions require the same level of engagement and an individual members' need for facility and experience with financial matters will depend upon the credit union, its complexity and asset size. NAFCU believes that generally the need for experience increases with the asset size; however, a more reliable indicator of the need for experience would be the risk profile of the credit union.

Therefore, if the Board should impose an experience requirement upon credit unions, it should be risk-based and imposed on a case-by-case basis. However, the Board should not mandate what form the experience should take; rather, any final rule should be flexible and permit various combinations of education and work experience to satisfy the requirement. In this and all regulatory requirements, NAFCU believes that a one-size-fits-all approach rarely works.

11. *Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have access to their own outside counsel? If so, at what minimum asset size threshold?*

NAFCU does not support a requirement for Supervisory Committee members to have access to their own outside counsel; rather, it believes Supervisory Committees should have the option of engaging outside counsel. Therefore, the Supervisory Committee should have the necessary spending authority to retain counsel. The ability of the Supervisory Committee to retain counsel should be available to all Supervisory Committees and not be based upon asset size.

12. *Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be prohibited from being associated with any large customer of the credit union other than its sponsor? If so, at what minimum assets size threshold?*

The prohibition contemplated in this requirement would seem to be aimed at preventing conflicts of interest between Supervisory Committee members and any large members of the credit union. While neither the Federal Credit Union Act nor the NCUA Rules and Regulations address this situation, NAFCU believes that such a requirement is necessary given the potential for conflicts of interest. However, NAFCU is concerned that the meaning of “large customer” is too vague to be useful in setting policy. Any final rule should provide clear guidance, if not a precise definition, on how the term should apply. Similarly, NAFCU is concerned that the word “associated” is too vague to be useful in setting credit union policy. We suggest that NCUA provide guidance on how the term should be applied.

NAFCU suggests that the Board consider the following existing language in the Federal Credit Union Bylaws, which applies to board members, as a model for prohibiting Supervisory Committee conflicts of interest, as it drafts any final regulation:

No director. . . shall in any manner, directly or indirectly, participate in the deliberation upon or the determination of any question affecting his pecuniary interest or the pecuniary interest of any corporation, partnership, or association (other than this credit union) in which he is directly or indirectly interested. In the event of the disqualification of any director respecting any matter presented to the board for deliberation or determination, such director shall withdraw from such deliberation or determination.
Article XIX, §4.

13. *If any of the qualifications addressed in questions 10, 11 and 12 above were required of Supervisory Committee members, would credit unions*

have difficulty in recruiting and retaining competent individuals to serve in sufficient numbers? If so, describe the obstacles associated with each qualification.

NAFCU believes the qualifications for Supervisory Committee members mentioned in questions 10 and 11 above would have a negative impact on the ability of credit unions to attract and retain volunteers to serve on the committee. The over all difficulty with any experience requirement is that it necessarily will shrink the pool of available candidates.

Depending on myriad factors such as the location, field of membership and sponsor-type, a credit union may have very few, if any, willing candidates. The difficulty in recruiting is complicated further by the inability of the credit union to compensate volunteers for the time, services and in the instant case, their financial management expertise. Another complication is the increased perception of personal liability of volunteers serving on the committee.

Independence of State-Licensed, Compensated Auditors

14. *Should a State-licensed, compensated auditor who performs a financial statement audit and/or "internal control attestation" be required to meet just the AICPA's "independence" standards, or should they be required to also meet SEC's "independence" requirements and interpretations? If not, why not?*

NAFCU does not support requiring a state-licensed, compensated auditor who performs a financial statement audit and/or internal control attestation to meet both the AICPA and the SEC independence standards. NAFCU believes that meeting the AICPA's independence standard is adequate, and that also adhering to the SEC's standard would provide minimal benefit and add unnecessary cost.

Audit Options, Reports and Engagements

15. *Is there value in retaining the "balance sheet audit" in existing § 715.7(a) as an audit option for credit unions with less than \$500 million in assets?*

NAFCU supports retaining the balance sheet audit for credit unions with less than \$500 million in assets as it provides an affordable option for smaller credit unions to obtain an independent audit.

16. *Is there value in retaining the "Supervisory Committee Guide audit" in existing § 715.7(c) as an audit option for credit unions with less than \$500 million in assets?*

NAFCU supports retaining the Supervisory Committee Guide audit for credit unions with less than \$500 million in assets as it provides an affordable audit option for smaller credit unions. This audit option, in particular, has tremendous value for very small credit unions.

17. *Should part 715 require credit unions that obtain a financial statement audit and/or an “attestation on internal controls” (whether as required or voluntarily) to forward a copy of the auditor’s report to NCUA? If so, how soon after the audit period-end? If not, why not?*

NAFCU does not support a requirement for credit unions that obtain a financial statement and/or an attestation on internal controls audit to forward a copy of the auditor’s report to NCUA. NAFCU believes that any reports that are prepared for a credit union’s management, board of directors or Supervisory Committee should be made available to NCUA upon request or at its regularly-scheduled examination.

18. *Should part 715 require credit unions to provide NCUA with a copy of any management letter, qualification, or other report issued by its external auditor in connection with services provided to the credit union? If so, how soon after the credit union receives it? If not, why not?*

NAFCU does not support a requirement for credit unions to provide NCUA with a copy of any management letter, qualification, or other report issued by its external auditor in connection with services provided to the credit union. NAFCU believes that any reports that are prepared for a credit union’s management, board of directors or Supervisory Committee should be made available to NCUA upon request or at its regularly-scheduled examination.

19. *If credit unions were required to forward external auditors’ reports to NCUA, should part 715 require the auditor to review those reports with the Supervisory Committee before forwarding them to NCUA?*

NAFCU does not support a requirement for credit unions to forward auditor reports to NCUA; however, it believes that the Supervisory Committee should receive copies of auditor reports and review them with the auditor as a matter of sound business practice. Furthermore, NAFCU believes that under Statement on Auditing Standards #61, auditors are required to have communications with audit committees regarding the conduct of the engagement and any waived or posted adjustments.

20. *Existing part 715 requires a credit union’s engagement letter to prescribe a target date of 120 days after the audit period-end for delivery of the audit report. Should this period be extended or shortened? What*

sanctions should be imposed against a credit union that fails to include the target delivery date within its engagement letter?

NAFCU believes that the 120-day target is sufficient in most cases and should not be changed; however, NAFCU believes NCUA should be flexible and grant an extension in cases that warrant it. NAFCU does not support a requirement that would impose sanctions on a credit union for not including the target date in an engagement letter. It is NAFCU's position that sanctions should only be imposed on a credit union when the target is missed and no extension was granted.

21. *Should part 715 require credit unions to notify NCUA in writing when they enter into an engagement with an auditor, and/or when an engagement ceases by reason of the auditor's dismissal or resignation? If so in cases of dismissal or resignation, should the credit union be required to include reasons for the dismissal or resignation?*

NAFCU does not support a general requirement for credit unions to notify NCUA in writing when they enter into an engagement with an auditor. This information is available upon request and during regularly-scheduled examinations.

However, with regard to cases where an auditor has been dismissed or resigned, NAFCU believes that the circumstances should be documented and NCUA informed of the reasons for dismissal or resignation as it may indicate problems within the credit union or with an auditor, which might have an impact on the insurance fund.

22. *NCUA recently joined in the final Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters, 71 FR 6847 (Feb. 9, 2006). Should credit union Supervisory Committees be prohibited by regulation from executing engagement letters that contain language limiting various forms of auditor liability to the credit union? Should Supervisory Committees be prohibited from waiving the auditor's punitive damages liability?*

NAFCU supports a regulation that prohibits Supervisory Committees from executing engagement letters which contain language limiting various forms of auditor liability to credit unions. Provisions limiting auditor liability jeopardize and weaken the integrity of the auditor's report and increase risk to the insurance fund.

Similarly, NAFCU supports a prohibition on Supervisory Committees accepting provisions waiving the auditor's punitive damages liability.

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NAFCU would like to thank you for this opportunity to share its views with regard to whether NCUA should amend its Supervisory Committee audit rules. Should you have any questions or require additional information please call me or Bill Hall, NAFCU's Associate Director of Regulatory Affairs, at (703) 522-4770 or (800) 336-4644 ext. 268.

Sincerely,

A handwritten signature in black ink, appearing to read "Fred R. Becker, Jr.", with a stylized flourish at the end.

Fred R. Becker, Jr.
President/CEO

FRB/whh